**DEPARTMENT OF STATE REVENUE**

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**Letter of Findings: 01-0358**
**Indiana Corporate Income Tax**
**For 1997, 1998, and 1999**

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## ISSUE

**I. Goods Shipped from Taxpayer's Out-of-State Location by Customer-Arranged Common Carrier – Adjusted Gross Income Tax / Supplemental Net Income Tax.**

**Authority:** IC § 6-3-2-1(b); IC § 6-3-2-2(b); IC § 6-3-2-2(e); IC § 6-3-2-2(e)(1); IC § 2-5-3-1; 45 IAC 3.1-1-53; Miller Brewing Company v. Ind. Dept. of State Revenue, 836 N.E.2d 498 (Ind. Tax Court 2005); Miller Brewing Company v. Ind. Dept. of State Revenue, 831 N.E.2d 859 (Ind. Tax Ct. 2005); Dept. of Revenue v. Bulkmatic Transport, 648 N.E.2d 1156 (Ind. 1995); General Motors Corp. v. Indiana Dep't of State Revenue, 579 N.E.2d 399 (Ind. Tax Ct. 1991); 45 IAC 3.1-1-53(7); Commonwealth of Penn. v. Gilmour Mfg. Co., 822 A.2d 676 (Pa. 2003); Revenue Cabinet v. Rohm and Haas Ky., Inc., 929 S.W.2d 741 (Ky. Ct. App. 1996); McDonnell Douglas Corp. v. Franchise Tax Bd., 33 Cal. Rptr. 2d 129 (Cal. Ct. App. 1994); Texaco, Inc. v. Groppo, 574 A.2d 1293 (Conn. 1990); Pabst Brewing Co. v. Wis. Dep't of Revenue, 387 N.W.2d 121 (Wis. 1986); Lone Star Steel Co. v. Dolan, 668 P.2d 916 (Colo. 1983); Olympia Brewing Co. v. Comm'r of Revenue, 326 N.W.2d 642 (Minn. 1982); Dep't of Revenue v. Parker Banana Co., 391 So.2d 762 (Fla. Ct. App. 1980); Paccar Inc. v. State of Alabama Dept. of Revenue, No. CORP-04-715, 2006 Ala. Tax LEXIS 1 (Ala. Dept. of Rev. Admin. L. Div. Jan. 11, 2006); 2005 Multistate Corporate Tax Guide, "Corporate Income Tax" note 6, at I-632 to I-635; Jerome R. Hellerstein and Walter Hellerstein, State and Local Taxation: Cases and Materials 629 n.17 (7th ed. West Group 2001).

Taxpayer argues that is not subject to Indiana Corporate Income on the money received from the sale of taxpayer's goods to Indiana customers when the Indiana customers arranged for a common carrier to pick up the goods at the taxpayer's out-of-state location and deliver the goods to the Indiana customer's location.

## STATEMENT OF FACTS

Taxpayer is an out-of-state manufacturer which sells goods to Indiana customers. The transactions take place in three ways. The Indiana customer could pick up the goods at taxpayer's out-of-state location using the customers' own trucks ("in-customer's-own-conveyance sale"); the customers arrange for a third-party common carrier to pick up the goods for transport to the customers' Indiana location ("customer-arranged-transportation sale"); taxpayer arranges for a common carrier to pick up the goods at the out-of-state location ("retailer-arranged-transportation sale.").

**A. Audit Report:**

The Department conducted an audit review of taxpayer's business records and state tax returns. The audit report stated that for 1997, taxpayer included in the numerator of the sales factor only sales to Indiana customers where taxpayer arranged for common carrier delivery of the customers' order ("retailer-arranged-transportation sale"); for 1997, taxpayer did not include in the sales factor money received from Indiana customers where the customers arranged for the common carrier to pick up the goods ("customer-arranged-transportation sale").

However, the audit report noted that for 1998 and 1999, taxpayer did not report *any* sales to Indiana customers. The audit made an adjustment determining that "all destination sales shipped by common carrier would be subject to tax in the state of Indiana." ("retailer-arranged-transportation sales" and "customer-arranged-transportation sales").

The audit concluded that taxpayer had misinterpreted the Indiana Tax Regulations as follows:

> Taxpayer represents that they have nothing to do with the transportation arrangement made by the [Indiana customer].... and therefore, it should not matter to the Taxpayer whether it was the distributor's own truck or a common carrier, the sale cannot be allocated to Indiana under [45 IAC 3.1-1-53]. The term "in his own conveyance" should be inclusive of common carriers because it is the [customer] who arranged for them.

**B. Audit Conclusion:**

The audit stated its conclusion; "The taxpayer has nexus established in the state of Indiana and all destination sales shipped by common carrier would be subject to tax in the state of Indiana."

**C. Taxpayer Protest:**

Taxpayer disagreed and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer's representatives explained the basis for the protest. This Letter of Findings addresses taxpayer's challenge to the 2001 Audit Summary and the consequent request for a refund of tax.

## DISCUSSION

**I. Goods Shipped from Taxpayer's Out-of-State Location by Customer-Arranged Common Carrier – Adjusted Gross Income Tax / Supplemental Net Income Tax.**

Taxpayer disagrees with the imposition of additional Indiana Corporate Income Tax attributable to the audit report's analysis and conclusions. In addition, taxpayer requests a refund of corporate income tax for the years 1997 through 1999 pursuant to the decision rendered in Miller Brewing Company v. Ind. Dept. of State Revenue, 831 N.E.2d 859 (Ind. Tax Ct. 2005) (Miller I).

During 1997, 1998, and 1999, Indiana imposed a tax on each corporation's adjusted gross income attributable to "sources within Indiana." IC § 6-3-2-1(b). Where a corporation – such as taxpayer – receives income from both Indiana and out-of-state sources, the amount of tax is determined by a three-factor apportionment formula set out in IC § 6-3-2-2(b). That formula operates by multiplying taxpayer's total business income by a fraction composed of a property factor, a payroll factor, and a sales factor. IC § 6-3-2-2(b).

The "sales factor" consists of a fraction, "the numerator of which is the total sales of the taxpayer in [Indiana] during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year." IC § 6-3-2-2(e). Sales of tangible personal property are "in this state" if "the property delivered or shipped to a purchaser... within this state, regardless of the f.o.b. point or other conditions of the sale." IC § 6-3-2-2(e)(1).

As mentioned above, taxpayer arranges for the sale and transport of its product to Indiana customers in one of three fashions:

1. Taxpayer hired a common carrier to transport the product from taxpayer's out-of-state location to the customer's Indiana location. For purposes of discussion, this is called a "retailer-arranged-transportation sale."
2. Indiana customer hired a common carrier to transport the product from taxpayer's out-of-state location to Indiana customer. This type of transaction is called a "customer-arranged-transportation-sale."
3. Indiana customer used its own vehicles – not those of common carrier – to pick up the taxpayer's product at taxpayer's out-of-state location and transported the product to Indiana. This type of transaction is called an "in-customer's-own-conveyance" sale.

The issue – just as it was in Miller Brewing Company v. Ind. Dept. of State Revenue, 836 N.E.2d 498 (Ind. Tax Court 2005) (*Miller II*) and Miller Brewing Company v. Ind. Dept. of State Revenue, 831 N.E.2d 859 (Ind. Tax Ct. 2005) (*Miller I*) – is whether Indiana is entitled to tax the income taxpayer earns from "customer-arranged-transportation" sales to Indiana. Taxpayer concedes that Indiana's sales sourcing-statute, IC § 6-3-2-2(e)(1), sources retailer-arranged-transportation sales to Indiana's sales factor. Miller I, 831 N.E.2d at 860. In Miller I, the Department purportedly conceded that Indiana's sales sourcing statute did not require that "in-customer's-own-conveyance" sales should be included in the sales factor numerator. Id.

The issue is whether "customer-arranged-transportation" sales are included in the sales factor. Taxpayer believes that Miller II and Miller I are dispositive of the issue; the Department believes that – contrary to those decisions - IC § 6-3-2-2(e)(1) mandates the adoption of a "destination rule." ("[I]f the shipment terminates in this state there is a delivery or shipment within this state and the sale is deemed [within the state]. Olympia Brewing Co. v. Comm'r of Revenue, 326 N.W.2d 642, 861 (Minn. 1982)). The Department asserts that Indiana should source out-of-state "customer-arranged transportation" sales to Indiana's sales factor as long as the product comes directly to Indiana.

In Miller I, the court agreed with petitioner's position that 45 IAC 3.1-1-53(7) should be broadly construed to exclude "customer-arranged-transportation" sales. Miller I, 831 N.E.2d at 862. The Department's regulation, on which the Tax Court relied, states in relevant part:

> Gross receipts from the sales of tangible personal property... are in this state: (a) if the property is delivered or shipped to a purchaser within this state regardless of the F.O.B. point or other conditions of sales; or (b) if the property is shipped from an office, store, factory, or other place of storage in this state, and the taxpayer is not taxable in the state of the purchaser. 45 IAC 3.1-1-53.

45 IAC 3.1-1-53 provides a series of examples to clarify the rule including "Sales are not 'in this state' if the purchaser picks up the goods at an out-of-state location and brings them back into Indiana in his own conveyance." 45 IAC 3.1-1-53(7).

Miller I, has been interpreted to mean that Indiana has adopted a "place of delivery" rule. "By promulgating [45 IAC 3.1-1-53(7)] Indiana has in effect adopted the 'place of delivery rule'... because the purchasers through their common carrier agents, picked up the [product] outside of Indiana, the sales were not Indiana sales for sales factor purchases." Paccar Inc. V. State of Alabama Dept. of Revenue, No. CORP-04-715, 2006 Ala. Tax LEXIS 1, at *8 (Ala. Dept. of Rev. Admin. L. Div. Jan. 11, 2006); *See* Miller I, 831 N.E.2d at 862.

Upon respondent Department's motion to correct error, the tax court declined to consider the Department's argument that, "the [Tax Court] failed to interpret Indiana Code § 6-3-2-2(e) as mandating a 'destination rule' instead of a 'place-of-delivery rule' for the designation of in-state taxable sales... [and] the Court's decision will cause absurd consequences and violate the dormant Commerce Clause of the United States Constitution." Miller II, 836 N.E.2d at 499. The court declined to consider these arguments because they were "entirely new arguments supported by law and supplements not introduced in the initial proceeding." Id. Because the statutory and constitutional arguments were not raised during Miller I, the court stood by its initial decision – based upon the "place of delivery rule" it discerned in 45 IAC 3.1-1-53(7) – commenting that, "The Court committed no error

and the Court will not correct the error of the Department or its counsel." Id. at 500.

The Department must respectfully disagree that Miller II and Miller I are dispositive of the taxpayer's challenge to the conclusions reached in the 1997 through 1999 audit report. If, as the court found in Miller II, the Department erred in failing to properly preserve the statutory and constitutional questions it raised in Miller II, the Department believes it is appropriate now to reconsider those questions and to correct the former erroneous omissions.

IC § 6-3-2-2(e)(1) provides as follows: "Sales of tangible personal property are in this state if: (1) the property is delivered or shipped to a *purchaser*, other than the United States government, *within this state*, regardless of the f.o.b. point or other conditions of sale[.]" (*Emphasis added*). Each state which has a statute identical to IC § 6-3-2-2(e)(1) has concluded that the phrase "within this state" modifies the word "purchaser," thereby mandating – contrary to the result in Miller I – a destination rule. *See* Commonwealth of Penn. v. Gilmour Mfg. Co., 822 A.2d 676 (Pa. 2003); Revenue Cabinet v. Rohm and Haas Ky., Inc., 929 S.W.2d 741 (Ky. Ct. App. 1996); McDonnell Douglas Corp. v. Franchise Tax Bd., 33 Cal. Rptr. 2d 129, 132 (Cal. Ct. App. 1994); Texaco, Inc. v. Groppo, 574 A.2d 1293 (Conn. 1990); Pabst Brewing Co. v. Wis. Dep't of Revenue, 387 N.W.2d 121 (Wis. 1986); Lone Star Steel Co. v. Dolan, 668 P.2d 916 (Colo. 1983); Olympia Brewing Co. v. Comm'r of Revenue, 326 N.W.2d 642 (Minn. 1982); Dep't of Revenue v. Parker Banana Co., 391 So.2d 762 (Fla. Ct. App. 1980). These states have uniformly concluded that the phrase, "regardless of the f.o.b. point or other conditions of the sale," means that a sale's sourcing does not depend on where the buyer acquired title to, or possession of purchased goods. These states – having a sourcing statute identical to IC § 6-3-2-2(e)(1) – have uniformly concluded that the statutory provision mandates a "destination" rule.

The Department is unable to agree that taxpayer's single-minded reliance on the Tax Court's interpretation 45 IAC 3.1-1-53(7) is sufficient to justify excluding its "customer-arranged-transportation" sales from the apportionment calculation by virtue of a "place of delivery rule" and render Indiana the "odd state out." The Department believes that taxpayer's position is wholly at odds with IC § 6-3-2-2(e)(1), the interpretation placed upon that statutory language by the states which – like Indiana – follow the Uniform Division of Income for Tax Purposes Act ("UDITPA"), and the fact that even states that have not adopted UDITPA – but impose a corporate income tax – use a destination rule. 2005 Multistate Corporate Tax Guide, "Corporate Income Tax" note 6, at I-632 to I-635; Jerome R. Hellerstein and Walter Hellerstein, State and Local Taxation: Cases and Materials 629 n.17 (7th ed. West Group 2001).

In addition, the Department does not agree that taxpayer has met its burden of demonstrating that it is entitled to exempt the "customer-arranged-transportation" Indiana sales from the formulary apportionment. Taxpayer's position flies in the face of the well established principle that "ambiguous exemption statutes are to be strictly construed against the taxpayer." Dept. of Revenue v. Bulkmatic Transport, 648 N.E.2d 1156, 1159 (Ind. 1995); General Motors Corp. v. Indiana Dep't of State Revenue, 579 N.E.2d 399, 404 (Ind. Tax Ct. 1991). Even if the Department were willing to accept taxpayer's position that 45 IAC 3.1-1-53(7) renders IC § 6-3-2-2(e)(1) ambiguous, the Department does not agree that taxpayer has met its burden of demonstrating that it is presumptively entitled to the sought-after exclusion.

The Miller I decision entirely removes taxpayer's "customer-arranged-transportation" sales from Indiana taxation. Taxpayer's own home-state uses the majority "destination rule" and sources taxpayer's "customer-arranged-transportation" sales to Indiana for income taxation. As a result, taxpayer's home state does not impose its own income tax on these sales thereby making the "customer-arranged-transportation" sales "nowhere sales;" these sales are sourced to no state and are free from taxation. The result is that in-state taxpayers, who make "customer-arranged-transportation" sales to non-Indiana customers will be required to source these sales to Indiana while out-of-state taxpayers, engaging in the same type of transaction, will be insulated from paying tax to any state. The taxpayer's position conflicts with Indiana's revenue policy found at IC § 2-5-3-1 which mandates a "revenue raising structure in Indiana that will provide adequate revenues to carry on the efficient operation of the state, county, and city governments and at the same time will assure that *its burdens will be share equitably by all taxpayers.*" (*Emphasis added*). The result taxpayer seeks is an anomalous tax-free zone which plainly contradicts the Indiana General Assembly's intent as set out IC § 2-5-3-1 and raises issues of a practical, equitable, and constitutional dimension.

Notwithstanding the decision set out in Miller I, IC § 6-3-2-2(e)(1) establishes a destination rule. The Department agrees with the audit report's conclusion that the "customer arranged transportation" sales should have been included in the formulary apportionment for Indiana Corporate Income Tax purposes.

**FINDING**

Taxpayer's protest and request for refund is respectfully denied.

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